MARKET FLASH: MACROECONOMIC DATA COME TO THE RESCUE

November 17, 2017

On the markets

European markets started the week by falling further but investors were then reassured by macroeconomic data reflecting strong growth in Europe and the US.

Germany's third quarter GDP accelerated to an annualised +2.8%, or largely above the least optimistic expectations of +2.3% and the two previous quarters were also revised higher. The generally upbeat trend was reinforced by Italian GDP which rose to +1.8% from +1.5% in the previous quarter, while the eurozone's GDP was confirmed at +2.5% (the Bloomberg consensus for France is +1.8%). The acceleration was largely due to a recovery in global trade and restocking. The figures failed to fuel inflation in the eurozone which actually fell 0.3% (and was at +1.2% in Germany and 0.9% in Spain) but they did trigger a rally in the euro which advanced to 1.186 against the US dollar on Wednesday.

In the US, despite some progress over tax reform, some doubts remained and weighed on sentiment amid disagreements between the Senate and the House of Representatives. Risk aversion rose and so did equity market volatility with the VIX hitting 13.3, a level not seen in more than 2 months. Fundamentally, the US economy is still doing well with industrial production up 0.9% in October (+2.9% over a year) thanks to the chemicals, oil and autos sectors. Manufacturing jobs also improved with 156,000 job creations over the last 12 months, the strongest annual pace of growth since mid-2015.

Meanwhile, emerging countries have run out of a little steam: advanced indicators remain upbeat, but the good news has started to thin out. Central banks in Russia and Brazil will continue to stimulate their economies but oil prices and an expected slowdown in China's growth will put the brakes on emerging zone growth in coming months. Beijing's efforts to moderate the pace of Chinese growth are having increasingly visible results: the slowdown in new lending, and especially shadow banking, seeks to clean up the financial system but is inevitably hurting growth rates. And data on consumption and investment released at the beginning of the week confirmed a slowdown in activity in the fourth quarter. Russia is seeing the same trend: third quarter GDP came in at +1.8%, down from +2.5% in the previous quarter. The economy saw a sharp rebound at the beginning of 2017, but household consumption has since failed to offset slowing industrial production and lack of reform is still restricting potential growth.

One of the most significant events of the week was the sharp decline on the European and US corporate bond markets. Bad news from Altice and Astaldi triggered profit taking across the board, especially as the segment had performed so well year to date.

Last week we were in cautious mood but this week we took some profits on our European equity hedges and slightly increased our US dollar exposure. But our allocations were unchanged.

EUROPEAN EQUITIES

European markets remained week initially but recovered after Thursday. The euro's strength against the US dollar played a part due to uncertainties over US tax reform and upbeat economic figures in Europe, notably Germany's third quarter GDP which beat expectations. Export stocks were hit the worst. A fall in oil prices also hit oil sector stocks while commodities suffered after China's president expressed a preference for the quality of Chinese growth rather than its size.

The mostly unexceptional earnings season came to an end. **Bouygues** beat expectations thanks to its telecom division. The group continued to win over mobile, fixed line and fibre subscribers and a slight increase in ARPU helped EBITDA improve. Management raised its margin objectives for 2017 from "above 25%" to 26-27% and also confirmed a rebound in orders in its construction business. **Iliad** in contrast released generally disappointing figures, with the exception of new mobile subscribers, while **Altice** plunged further.

Airbus rose on a record order for 430 A320neo planes worth more than $40bn in its catalogue. **Alstom** also released upbeat results and confirmed its 2020 guidance for an annual like-for-like rise of 5% and an adjusted operating margin of 7%.

EDF tumbled after its quarterly results and lower forecasts for EBITDA in 2018. Germany's power companies were hit by profit taking after a good year and despite good third quarter results from **RWE**. **Leonardo** fell further on fresh downgrades and difficulties in its helicopter business.

The US fund Cerberus which already holds 5 % of **Commerzbank**, has just bought a 3% stake in Germany's largest bank, **Deutsche Bank**, a move which revived rumours of a giant merger.

US EQUITIES

US indices were unchanged over the period despite some volatility. There was good news on inflation, both the CPI and PPI, and also from October retail sales (+0.3% ex autos and petrol) as well as industrial production which rose 0.9% over the same month. Tax reform cleared a new hurdle after the text was adopted by the House of Representatives.

Tech stood out as the earnings season came to an end. **NetApp** saw growth accelerate and margins improve, **Cisco** returned to growth and pressed on with its transition towards a subscription model.

Elsewhere, **Walmart** surprised markets and jumped 10% after unveiling a 2.7% increase in like-for-like sales and a surge in on-line sales.

Consumer staples, consumer discretionary and utilities ended the period higher while industrials and energy declined.

JAPANESE EQUITIES

The TOPIX fell for 6 straight sessions, losing 2.15% over the week; its largest drawdown in eight months, on Wall Street's decline and the Yen's strength against the US Dollar. However, the index remained above 22,000 thanks to buying on dips.

The market rebounded sharply on Thursday and moved into positive territory on brisk company earnings and improved investor sentiment as the yen's rise paused. Oil companies and steel makers lost ground and export stocks were weak due to the stronger Yen.

By sector, the best performer of the week was Other Products (+0.31%). **Shiseido** (+5.03%) and **Nintendo Co** (+3.44%) advanced on upward revisions by major brokers.

All other sectors declined, and the worst performers were Mining (-6.80%), Warehousing & Harbor Transportation Services (-6.67%) and Marine Transportation (-6.12%). Oil companies **Inpex Corporation** (-7.06%) and **JXTG Holdings** (-4.39%) met selling on a further fall in crude oil prices. Steel makers **Nippon Steel & Sumitomo Metal** (-6.37%), **JFE Holdings** (-5.89%) and **Sumitomo Metal Mining** (-5.40%) were also downbeat.

EMERGING MARKETS

Tencent published results above expectations with topline growth of 61% YoY. Tencent Video became the Chinese leader in fee-based subscription applications, doubling the number of subscribers YoY to over 43 million. Non-GAAP EPS rose 45% YoY, or 4% better than consensus estimates. Margins were still down due to investment in video, and higher revenue contributions from the payment and cloud businesses. **JD.com** reported a massive 162% rise in results due to economies of scale generated by a strong 39% surge in sales. However, investor reactions were muted as more than 100 domestic brands are leaving the apparel business platform. Management is guiding for further margin improvement. Elsewhere, **Samsonite**'s adjusted EBITDA rose 19% and the integration of TUMI is on track.

In the video game space, Korea's **NCSOFT** saw operating results multiplied by an impressive 5 times. In China, **Netease** unveiled an 8% drop in YoY results despite decent topline growth of 35%. However, investors shrugged this off as management was very optimistic about monetizing the sandbox competition game. In India, **Eicher Motors** continues to deliver strong results which were up 25% with order intake for Royal Enfield exceeding production. In the Infrastructure space, news flow was mixed. **Adani Ports**' recurring EBITDA growth was only 2% YoY. **Larsen & Toubro** saw earnings increase 39% but with lower order inflows. Inflation in India was slightly higher than expected at 3.6% in October, mainly due to food prices.

Retail sales in **Brazil** continued to recover slowly, rising 6.4% YoY in September.

In **Argentina**, an article in 'La Nacion' suggested that Jorge Brito (Banco Macro's chairman) and former Vice President Amado Boudou had played a part in the ongoing corruption scandal by financing Old Fund, a shell company that was used to take the control of banknote printing press Ciccone. There are fears that this could trigger a giant anticorruption movement which could freeze ongoing reforms in Argentina.

In **Mexico**, the fifth round of NAFTA negotiations has just started. We do not expect any major developments in the short term.

COMMODITIES

WTI and Brent crude lost between $1.5-2 over the week as the IEA cut its forecasts for demand in 2017 to 1.5 million from 1.6 million b/d, citing higher prices and expectations of reduced consumption over the winter period. 2018 was also reduced from 1.4 to 1.3 million b/d. The agency maintained 2017 growth at +0.7 million b/d for non-OPEC demand but cut 2018 to +1.4 million b/d. OECD inventories have fallen sharply from peak levels but are still above the 5-year mean and the agency sees no further reductions in 2018.

Oil prices have now risen 40% to above $60 for Brent crude since the June low. This reflects improving fundamentals but does not make it easy to extend production cuts beyond March 2018. In fact, higher prices led to increased drilling last week with the rig count up 9, its strongest weekly rise since last June. The good news is that US shale oil exploration and production companies are increasingly focusing on creating value and generating free cash flow rather than going all out for higher volumes. We expect trading to be nervous up to the OPEC/non-OPEC meeting on November 30.

China's latest economic data point to a slowdown in growth. Industrial production rose 6.2% in October compared to +6.6% in September. Fixed capital investment fell from +5.3% to+3.2%, and electricity consumption from +5.3% to +2.5%, triggering a 1.3% drop in metal prices on the LME.

Nickel tumbled 7.8%, giving back last week's exaggerated surge. We should, however, put the data in perspective as they also reflect the slowdown during October's Communist Party Congress.

CORPORATE DEBT

CREDIT

Spreads widened again this week due largely to profit taking and specific risk from companies like **Altice**, **Astaldi** and **Teva**. Most segments underperformed especially high beta corporates and CoCos. However, the market rebounded from Thursday on as buyers appeared.

Altice (B1/B+) continued to underperform on both equity and bond markets as volatility surged. But the group enjoyed a rebound at the end of the week after announcing that it was to focus on cutting net leverage and debt.

Salt (Matterhorn Telecom, B2/B) raised €400m with a 10-year senior bond. **Verisur** (Caa1, alarms and remote security systems), sold a 6-year senior bond in two tranches, one in euros and the other in Swedish crowns, and with a fixed and floating coupon.

In a busy week for results, **Telecom Italia** (Ba1/BB+) released satisfying results and confirmed its 2017 targets. Sales rose 1.3% on improved Italian revenues. In Brazil, **Adler Real Estate AG** (BB), a German company, unveiled upbeat quarterly results and confirmed its 2017 guidance. Occupancy rates edged higher to 89.9% and net rental income rose 5.5% to €44.1m. Results for the first 9 months at **Cellnex** (BB+), a European wireless phone infrastructure company, were in line with sales up 11.4% and adjusted EBITDA 25%, higher thanks to strong performance in its mobile infrastructure division (59% of sales). Results for the first 9 months at Italian construction company **Astaldi** (B3/B-/B+), were hit by the partial depreciation of its exposure to Venezuela and its very high debt levels. Q3 sales slumped 10.3% while net debt rose by €117m over the quarter.

The group confirmed it intention of launching a €200m capital increase but gave few details. **Hapag Lloyd** (B2/B, container shipping) saw sales jump 52% and EBITDA surge 101% due to a recovery in freight.

CONVERTIBLES

US chip maker **Rambus** raised $150m with a 2023 convertible at 1.375%. The proceeds will be used to refinance the existing 2018 convertible.

We may well some convertible issuance ahead of Thanksgiving (November 23).

The €750m **La Caixa/Caixabank** 1% 2017 convertible falls due next week.

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